Service Date: July 5, 1984

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER of the Application of	)	UTILITY DIVISION
The City of Havre to Increase Rates	)	DOCKET NO. 84.2.7
and Charges for Water Service.	)	ORDER NO. 5068

APPEARANCES

FOR THE APPLICANT:

James Spangelo, City Attorney, P.O. Box 231, Havre, Montana 59501

FOR THE INTERVENORS:

Frank Buckley, Representing the Montana Consumer Counsel, 34 West Sixth Avenue, Helena, Montana 59620

FOR THE COMMISSION:

Robert A. Nelson, Staff Attorney, 2701 Prospect Avenue, Helena, Montana 59620

BEFORE:

DANNY OBERG, Commissioner and Hearing Examiner

BACKGROUND

1. On February 2, 1984, the City of Havre (Applicant or City) filed an application with this Commission for authority to increase rates and charges for water service to its customers in the Havre, Montana area. The Applicant requested an average increase of approximately 77 percent which constitutes an increase of approximately $441,000 in annual revenues.

2. On March 22, 1984, pursuant to notice of public hearing, a hearing was held in the City Council Chambers, City Hall, Havre, Montana. The purpose of the public hearing was to consider the merits of the Applicant's proposed water rate adjustments. At the close of the public

hearing, all parties waived their rights to a proposed order and stipulated to authorize the Commission to issue a Final Order in this Docket.

ANALYSIS AND FINDINGS OF FACT

3. At the public hearing the Applicant presented the following witnesses:

Ray Watson, Mayor
Fred Hartson, Director of Public Works
Doug Allison, General Foreman
Tom Meddings, Superintendent Water Plant
Mike Marianni, City Clerk
Kreg Jones, Financial Consultant
Tom Thomas, Consulting Engineer

These witnesses testified relative to: the need for proposed capital improvements, the estimated cost of the proposed capital improvements, the financing of the proposed capital improvements, the increases in operation and maintenance expense, service problems and rate structure.

4. The Montana Consumer Counsel presented the testimony of six main concerns expressed by the public witnesses. The main concerns expressed by the public witnesses were the magnitude of the proposed rate increase and its impact on fixed income consumers.

5. The fiscal year ending June 30, 1983 is found to be a reasonable test year period within which to measure the Applicant's utility revenues and expenses for the purpose of determining a fair and reasonable level of rates for water service.

Capital Improvement Program

6. The City in its application has set forth a proposed capital improvement program for the water utility. The total estimated cost of the capital improvement program as outlined by the City is $7,430,000. The following Table 1 sets out the proposed capital improvements to the water system and their estimated cost, in order of priority as established by the City.

TABLE 1

1.	Repair of Weir	$ 170,000
2.	Install two 8" Pressure Reducing Valves	30,000
3.	Improvements to Water Plant	383,000
4.	Repair Existing Storage Tanks	180,000
5.	Replace 1450 L. F. of 16" Main from Water Plant	70,000
6.	Construct 3.5 MG Reservoir	650,000
7.	Install 4,100 feet of new 16" pipe to connect to new reservoir	178,000
8.	Fire hydrant replacements and distribution piping	719,000
	SUBTOTAL	$2,380,000
9.	Balance of distribution piping	3,550,000
10.	Manganese removal	1,500,000
	TOTAL	$7,430,000

7. Because of the magnitude of the improvements required, the City has chosen to defer construction of a portion of the capital improvements, outlined in Table 1. The City has determined that items 1 through 8 in Table 1 are priority items and has requested that these capital improvements be considered in this Docket.

8. The City proposes that the capital improvements under consideration in this Docket be funded from a Revenue Bond issue having a maximum term of 20 years and a maximum interest rate of 11 percent, with the requirements that the City have a reserve fund in an amount equal to the maximum principal and interest payment on the bond and provide a debt service coverage of 125 percent.

9. Item 1 of the proposed capital improvement program is repair of the weir, which is the structure diverting water from the Milk River to the water treatment plant. The weir was damaged during a period of high water on the Milk River in 1977, and the City has not had sufficient funds available to make the necessary repairs. The total estimated cost of this program is $645,980. The City has received a state grant in the amount of $475,980 to help finance this project, leaving a balance of $170,000 to be provided by the City.

10. Items 2, 4, 5, and 8 of the improvement program are for the construction of improvements to the City's distribution system to insure and improve the available supply of water to various areas of the City. The total estimated cost for these improvements is $999,000.

11. Item 3 of the capital improvement program, improvements to water plant, is for funding of a partial renovation of the City's water treatment plant. The existing water treatment plant was built in 1950, and since that time has received funding for capital improvements on an emergency basis only. The City, in its Exhibit No. 5 at page 27, identified 12 capital improvements that it deemed necessary to insure continued satisfactory operation of the water treatment facility, and indicated the total cost of these improvements would be $383,000.

12. Items 6 and 7 of the capital improvement program relate to the construction of a new 3.5 million gallon reservoir. The City in its testimony and exhibits indicated that, during periods of high water demand, the present storage capacity is inadequate and results in virtual depletion of stored water in its reservoirs. The City's witnesses stated that the additional storage is needed to allow operational flexibility between the wells and the water plant, to insure adequate water supply during period of peak water demand and to insure adequate fire flows. The total cost of this capital improvement is $828,000.

13. The Commission finds, based upon the testimony of the City's witnesses, that the capital improvement program as proposed by the City is reasonably prudent and therefore accepts the improvements as outlined. The Commission also accepts the City's estimated cost of $2,380,000 as being a reasonable estimate of the construction costs.

Debt Service

14. The City proposes to finance the capital improvements outlined in Table 1, items 1 through 8, of this Order by the issuance of revenue bonds.

The City proposes to issue $2,875,000 in revenue bonds to be repaid over a period of 20 years with the requirements that the City capitalize from the bond proceeds a reserve fund in an amount equal to the maximum principal and interest payment on the bonds and provide a debt service coverage of 125 percent.

15. The Applicant currently has an outstanding revenue bond that it does not anticipate retiring with the issuance of the proposed $2,875,000 bond issue. Therefore before it can issue additional revenue bonds, on a parity with the currently outstanding issue, it must meet the requirements outlined in Section 4.03 of Ordinance No. 657 (current Revenue Bond Ordinance). This section requires that the City's bond coverage requirement of 125 percent must have been achieved for the last complete fiscal year preceding the issuance of additional bonds and that the fund balances required by this Ordinance (No. 657), totaling $70,947, may not be deficient at the time additional bonds are issued.

The City has met the requirement that it achieve the 125 percent bond coverage but at the present time its fund balances as required in Ordinance No. 657 are deficient. The City, at the end of fiscal year 1983, had a net fund balance of a negative $32,101. This negative fund balance has accumulated because over the years the City water department has borrowed money from the Special Improvement District Revolving Fund to cover the costs of necessary capital improvements to the water system, when water department revenues were insufficient to pay those costs.

16. Before the City will have the ability to issue additional revenue bonds it will be necessary for it to find a source of funding that will allow it to accumulate the required reserve fund balances stipulated to in Ordinance No. 657. The City has proposed that the fund balance deficiency totaling $103,048 ($32,101 deficiency + $70,947 required fund balance = $103,048) be included in the proposed revenue bond issue. The City's financial consultant, Kreg Jones of D.A. Davidson & Co., indicated that this financing mechanism would satisfy the requirements of Ordinance No. 657 and allow the City to issue additional revenue bonds.

The Commission finds the City's proposal to include funding of the required reserves in the amount of $103,048 acceptable, but does want to communicate to the City its feeling that the City has been remiss in monitoring the adequacy of its water rates by allowing this situation to occur.

17. In any sale of municipal bonds, the purchasers of the bonds must be assured that their investment is secure. To provide this security, the municipality makes a promise, called a covenant, to do certain things that will ensure that it will always be able to pay the bond's principal and interest as they come due. In this instance, the City proposes to include covenants agreeing to establish a

bond reserve fund in an amount equal to the maximum principal and interest payment on the bond, in the amount of $361,300, which will be capitalized from the bond proceeds and provide a coverage ratio of 125 percent.

18. The Commission finds the bond covenants, establishment of a reserve fund and the 125 percent coverage ratio, to be among the standard requirements for the issuance of revenue bonds and therefore accepts the requirements.

19. The Commission finds the issuance of $2,875,000 in revenue bonds with a maximum term of 20 years and a maximum interest rate of 11 percent, with the requirements that the City establish a bond reserve in an amount equal to the maximum principal and interest payment on the bonds and provide a debt service coverage of 125 percent, is appropriate.

20. When the City completes the sale of the proposed revenue bond it will incur a maximum annual principal and interest payment on all outstanding revenue bonds of approximately $409,000. It will also incur the obligation to have a net operating income of at least $102,250 to meet the requirement that it achieve a 125 percent coverage ratio. To determine net operating income, operation and maintenance expense, as well as debt service, are subtracted from the total revenues of the utility. The required net operating income is calculated by multiplying the annual principal and interest payment on outstanding bonds by 25 percent ($409,000 x .25 = $102,250).

Operation and Maintenance Expense

21. The test year in this case is the fiscal year ending June 30, 1983, adjusted for inflation and inclusion of the expense for hiring one additional employee assigned to the water department. The test year operation and maintenance expenses totaling $503,000 were not challenged by any party

therefore, accepted by the participating in this proceeding and are, therefore, accepted by the Commission.

22. The Commission finds the following test year operating revenue deductions to be reasonable:

Operating Expense	$ 503,000
Debt Service	409,000
Debt Service Coverage	102,250
TOTAL	$1,014,250

The test year expense assumes full annualized costs for the proposed revenue bond issue. The Commission chooses to calculate expenses in this manner, as it is the most reasonable way of accounting for the effect of the proposed bond issue on the operating statement of the utility.

Revenue Need

23. The City indicated that, under the present rates, which became effective January 3, 1984, annual revenue generation would be approximately $570,000. The test period operating revenues are not a contested issue in this case and are, therefore, accepted by the Commission.

24. The Commission, based upon the Findings of Fact contained herein, finds that the Applicant should be allowed to increase revenues by $444,250. This requirement is calculated as follows:

Operating Revenue	$ 570,000
LESS :	
Operating Expense	$ 503,000
Debt Service	409,000
Debt Service Coverage	102,250
Total Revenue Requirement	$1,014,250
REVENUE DEFICIENCY	$ 444,250

The revenue increase allowed of $444,250 is limited by the City's application and this Commission's notice of public hearing which reflected a maximum revenue increase in the amount of $441,000; therefore, the Commission recognizes a maximum allowable revenue increase of $441,000.

Rate Design

25. The Applicant's proposed rate structure is designed to generate total annual revenues of $1,011,000 and represents an annual revenue increase totaling $441,000. The proposed rate structure includes a bi-monthly customer charge and a two block declining commodity charge applicable to all metered consumers connected to the water system.

26. There was concern expressed on the record, by public witnesses, relative to the degree of customer impact that would be experienced by consumers if the City were allowed to convert from its present six block declining commodity charge to a two block declining commodity charge. The Applicant presented a cost of service study and utilized the information contained in that study to develop its proposed rates. This study was not impeached during the course of the hearing and, therefore, is the most reliable information available for Commission use in determining the propriety of the City's proposed rate structure.

The cost of service study indicates that, on a customer class basis, the increase that will be experienced by each class is relatively uniform, ranging from a low of 77.3 percent to a high of 78.7 percent. While individual customers in each customer class will experience increases in excess of the class average, this is to be expected when a major rate structure modification is proposed.

27. Public witnesses Jim Sluter and Knute Kulbeck presented testimony expressing concerns on behalf of large volume water users due to the proposed rate design change. They stated that the proposed rates would result in severe economic hardships for the business community and could result in closures or business curtailments. The Commission shares the concern of consumer impacts from any utility rate increase but for the reasons outlined in this order the Commission finds that the City of Havre must have increased revenues from its water customers to insure adequate levels of service for its population.

The rate design, or the distribution of the needed revenues amongst the various customers, must in the Commission's mind be fair, assign the costs to customer classes based on the costs they impose on the system, give the consumer the proper price signal to encourage prudent use of a limited resource, and to avoid or delay future rate increases that could result from unwarranted increases in consumption.

The Commission finds that the City's rate design proposal is equitable and fairly recovers the cost of providing service to the various customers and therefore is accepted. The two step declining block does provide reasonable moderation for the large volume consumer in contrast to a flat or inverted structure. The rates established in this docket reflect the costs large commercial and industrial customers cause the system and will not result in these customers subsidizing residential service.

The residential customers who protested the increase because of impacts on the low income or aesthetic effects from an expected response of less lawn irrigating will be paying only for costs they impose on the system.

Increases for NMC are in line with other customer classes. The college has monitored this rate proceeding because of the administration's concern over the effect on their budget and the taxpayer. One of the Commission's accepted policies in utility ratemaking is that governmental bodies should not be subsidized by other utility consumers but rather supported by all taxpayers in the taxes they pay too for all governmental expenses.

Miscellaneous

28. Shirley Smith, owner and operator of a trailer park connected to the municipal water system, expressed concern over the City converting her trailer park from individually metered services to a master meter service. She requested that the Commission order the City to reinstitute service to her trailer park on an individual service basis.

The provision of water service through a master meter is a provision of service requirement and the Commission, pursuant to Title 69, Chapter 7, MCA, no longer has jurisdiction over municipal utility service rules. Therefore, the Commission makes no finding regarding this matter.

29. The City has acknowledged that there is a cost associated with the provision of fire protection and that it is recovering these costs by including them as a component of the monthly customer charge. The City, during the hearing, stated that it did not have sufficient information available to assess the charge in any other manner. The Commission, for purposes of this proceeding, has accepted the City's recovery of fire protection costs through fire protection cost recovery rate

inequities relative to the customer charge, but recognizes that fire protection cost recovery through a customer charge presents limited rate inequities relative to the various customer classes.

Variances exist in the cost of providing fire protection service to the various customer classes and in future proceedings before this Commission the City should be prepared to demonstrate that fire protection charges recognize these cost variances.

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and subject matter in this proceeding. Section 69-3-102, MCA.

2. The Commission afforded all parties interested in this proceeding proper notice and an opportunity to participate. Section 69-3-303, MCA.

3. The rates approved herein are reasonable, just and proper. Section 69-3-201. MCA.

ORDER

NOW THEREFORE, IT IS ORDERED THAT:

1. The City of Havre shall file tariffs consistent with the Findings of Fact for Docket No. 84.2.7 contained herein.

2. The City of Havre is authorized to issue a revenue bond in the amount of $2,875,000 with the requirements as outlined in Findings of Fact No. 19.

3. The City of Havre is authorized to file increased rates recognizing increased costs of operation and the costs associated with the proposed revenue bond. The rates shall become effective upon Commission approval subsequent to the issuance of the revenue bond.

4. The rates approved herein shall not become effective until the tariffs and the necessary calculations for the bond issue have been submitted for approval by the Commission.

5. A full, true, and correct copy of this order shall be sent forthwith by first class United States mail to the Applicant and all other appearances herein.

DONE IN OPEN SESSION at Helena, Montana, this 2nd day of July, 1984, by a vote of 5-0

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

THOMAS J. SCHNEIDER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill
Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.